National Association
of Bond Lawyers

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July 31, 2017

VIA Electronic Mail to Notice.Comments@irscounsel.treas.gov

Internal Revenue Service
CC:PA:LPD:PR (Notice 2017-38)
Room 5205
Washington, DC 20224

RE: Notice 2017-38, Implementation of Executive Order 13789 (Identifying and Reducing Tax Regulatory Burdens)

Ladies and Gentlemen:

Notice 2017-38 (the "Notice") identified the Proposed Regulations under Section 103 of the Internal Revenue Code on Definition of Political Subdivision (REG-129067-15; 81 F.R. 8870) (the "Proposed Regulations") as "significant tax regulations" that (i) impose an undue financial burden on U.S. taxpayers or (ii) add undue complexity to the Federal tax laws. The Notice also requested comments on whether the regulations described in the Notice should be rescinded or modified, and in the latter case, how the regulations should be modified in order to reduce burdens and complexity.

On May 23, 2016, the National Association of Bond Lawyers ("NABL") recommended by submission to www.regulations.gov (IRS REG-129067-15) that that the Proposed Regulations be withdrawn, and that the notice of withdrawal affirm the applicability of the Shamberg rule as the sole standard for evaluating a governmental entity's status as a political subdivision under section 103(c)(1) of the Code. NABL believes, for the reasons stated in that submission, which we have enclosed with this letter, that the Proposed Regulations have resulted in and, unless withdrawn, will continue to cause significant uncertainty and disruption in the financial markets and the legal community. Accordingly, NABL affirms its original request that the Proposed Regulations be withdrawn, and that the notice of withdrawal affirm the applicability of the Shamberg rule as the sole standard for evaluating a governmental entity's status as a political subdivision under section 103(c)(1) of the Code.

NABL exists to promote the integrity of the municipal bond market by advancing the understanding of and compliance with the law affecting public finance. We respectfully provide this submission in furtherance of that mission.

This submission was prepared by members of NABL's Tax Law Committee. If you have any questions concerning this submission, please contact William Daly, NABL's Director of Governmental Affairs, at 202-503-3303 or at bdaly@nabl.org.

Sincerely,

Clifford M. Gerber

Enclosure

cc: John J. Cross III

Vassiliki Tsilas

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May 23, 2016

Internal Revenue Service
CC:PA:LPD:PR (REG – 129067-15)
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044
www.regulations.gov (IRS REG-129067-15)

RE: Proposed Treasury Regulations Addressing the Definition of a "Political Subdivision" (REG-129067-15)

Ladies and Gentlemen:

The National Association of Bond Lawyers (NABL) respectfully submits the enclosed comments regarding the definition of "political subdivision" in the proposed Treasury Regulations, REG-129067-15, which were published in the Federal Register on February 23, 2016. These comments were prepared by a sub-group of the NABL Board of Directors and approved by the NABL Board of Directors. NABL intends to supplement these comments with a more detailed comment paper in the future.

NABL requests an opportunity to speak at the public hearing scheduled for June 6, 2016, at 10:00 a.m. NABL has separately provided an outline of its testimony and an estimate of the amount of time that will be spent on each topic.

NABL exists to promote the integrity of the municipal market by advancing the understanding of and compliance with the law affecting public finance. We respectfully provide this submission in furtherance of that mission.

If NABL can provide further assistance, please do not hesitate to contact Bill Daly in our Washington, D.C. office at (202) 503-3303.

Thank you in advance for your consideration of these comments.

Sincerely,

Kenneth R. Artin
Enclosure

COMMENTS BY THE NATIONAL ASSOCIATION OF BOND LAWYERS TO THE PROPOSED TREASURY REGULATIONS PUBLISHED ON FEBRUARY 23, 2016 ADDRESSING THE DEFINITION OF A "POLITICAL SUBDIVISION"

On February 23, 2016, the United States Treasury Department ("Treasury") and the Internal Revenue Service (the "IRS") published proposed United States Treasury Regulations (the "Proposed Regulations") related to the definition of political subdivision under section 103 of the Internal Revenue Code of 1986, as amended (the "Code"). The National Association of Bond Lawyers ("NABL") appreciates the consideration that Treasury and the IRS have given to the definition of political subdivision in the Proposed Regulations. As described below, however, NABL believes that the Proposed Regulations have resulted in and, unless withdrawn, will continue to cause significant uncertainty and disruption in the financial markets and the legal community. NABL believes that Treasury's and IRS's stated goal of providing greater certainty as to the definition of political subdivision has not been met. To the contrary, if the Proposed Regulations are adopted in the current form, there will be significant negative ramifications, including greater uncertainty regarding the definition of political subdivision. NABL intends to supplement these comments with more detailed comments in the future.

Current Law is Clear

Section 103(a) of the Code provides that, subject to certain exceptions, gross income does not include interest on any State or local bond. Section 103(c)(1) of the Code defines "State or local bond" to mean an obligation of a state or political subdivision thereof. Section 1.103-1(b) of the United States Treasury Regulations (the "Regulations") defines the term "political subdivision" as "any division of any State or local governmental unit which is a municipal corporation or which has been delegated the right to exercise part of the sovereign power of the unit." Section 1.103-1(b) of the Regulations goes on to provide, "[a]s thus defined, a political subdivision of any State or local governmental unit may or may not, for purposes of this section, include special assessment districts so created, such as road, water, sewer, gas, light, reclamation, drainage, irrigation, levee, school, harbor, port improvement, and similar districts and divisions of any such unit."

According to the preamble to the Proposed Regulations, the purpose of the Proposed Regulations is "to clarify the definition of political subdivision to provide greater certainty to prospective issuers and to promote greater consistency in how the definition is applied across a wide range of factual situations." Indeed, this is the only purpose offered in connection with the release of the Proposed Regulations. As discussed in greater detail in NABL's request for guidance regarding the definition of political subdivision submitted to Treasury and the IRS on November 21, 2013, which was supplemented by a memorandum submitted to Treasury and the IRS on April 30, 2014, prior to the release of Technical Advice Memorandum 201334038 (the "2013 TAM"), there was little uncertainty or controversy within the market or among legal practitioners as to what is required for an entity to qualify as a political subdivision. NABL's request for guidance in this area was prompted by the uncertainty created by the 2013 TAM, and NABL's suggestions would have restored certainty to this area of the law. The preamble to the Proposed Regulations refers to "numerous" requests for private letter rulings, yet we can find but six private letter rulings within the last 10 years on this issue, none of which were controversial. The latest IRS private letter ruling in this area was released over five years ago.

It is apparent that the uncertainty being addressed by the Proposed Regulations is the result of the IRS's position in its examination of two community development districts in Florida related to The Villages development, which gave rise to the 2013 TAM. There has been no independent development in the market or a change in the law that needed to be addressed,[1] but rather only this instance of the IRS's position in an examination causing significant uncertainty and disruption in the financial market and the legal community. The IRS created the legal issue that the Proposed Regulations now seek to solve. Unfortunately, the Proposed Regulations would only exacerbate the uncertainty created by the 2013 TAM by rejecting existing established legal precedent in favor of multiple layers of "facts and circumstances" tests. The Proposed Regulations take what was previously a relatively straightforward and accepted standard and convert it into multiple testing layers with little or no explanation of the relevant criteria.

In Philadelphia Nat'l Bank v. U.S., 666 F.2d 834 (3d Cir. 1981), cert. denied, 457 U.S. 1105 (1982), which is cited in the preamble to the Proposed Regulations, the United States Court of Appeals for the Third Circuit was asked to rule on whether Temple University ("Temple"), a private nonprofit university, which had agreed to be "incorporated" into the State of Pennsylvania educational system, was a political subdivision under section 103 of the Code. After addressing the amount of control over Temple held by the State, which control the opinion notes was lacking, the Court turned to what it meant to be a political subdivision under the Code. The Court's opinion states:

> Since we must resolve the question in the context of the Internal Revenue Code itself, we turn to the delegation of state sovereignty test mentioned in the Treasury Regulation and discussed in [Comm'r v. Shamberg's Estate, 144 F.2d 998 (2d Cir. 1944), cert. denied, 323 U.S. 792 (1945), and Comm'r v. White's Estate, 144 F.2d 1019 (2d Cir. 1944), cert. denied, 323 U.S. 792 (1945)]. The three sovereign attributes discussed are the power to tax, the power of eminent domain, and the police power.

While NABL recognizes that Treasury and the IRS are proposing new regulations, it is worth noting that the Third Circuit analyzed whether Temple had a substantial amount of the police power. Analysis of the three sovereign powers is the only standard mentioned in the context of whether Temple is a political subdivision after the Court states that it must "resolve the [political subdivision] question in the context of the Internal Revenue Code." Temple neither had the power to tax nor the power of eminent domain. The Third Circuit analyzed Temple's police power and concluded, "[w]ith such minimal grant of police power, and with no eminent domain or taxing power, Temple cannot be said to be a political subdivision."[2] Thus, the Third Circuit considered the question of sovereign powers, and not control or other criteria, to be dispositive of the question of whether Temple was a political subdivision. This standard was straightforward and easily applied for decades. The majority of the rulings in this area are the result of the application of the facts and circumstances substantial powers tests, which tests are not addressed (other than to note that the tests continue to apply) in the Proposed Regulations. NABL understands that Treasury and the IRS may have reasons for wanting to change longstanding law in this area, but the stated reason - clarification of the applicable standard for greater certainty – is undermined by the Proposed Regulations.

[1] Technical Advice Memoranda may not be relied upon as precedent.

[2] Philadelphia Nat'l Bank at 840.

The Proposed Regulations Are Not Administrable

The Proposed Regulations create significant new burdens on governmental organizations seeking to qualify, or maintain qualification, as political subdivisions. Aside from the technical issues associated with the new requirements announced in the Proposed Regulations (addressed below), the Proposed Regulations invite a considerable amount of uncertainty through the introduction of at least a half-dozen new ambiguous facts and circumstances tests. According to the U.S. Census Bureau, there are over 38,000 special district governments in the United States, including single- and multi-purpose governments of all types.[3] If the Proposed Regulations were adopted, the status of these districts would have to be reexamined to determine if they meet the new definition. The cost of doing so would be borne by these local districts, an expensive and unnecessary task.

The current accepted standard applied in evaluating whether an entity is a political subdivision apply but one test, the sovereign powers test. By contrast, the Proposed Regulations would require the analysis in the following table:

1. Does the organization possess a substantial amount of at least 1 of the 3 sovereign powers?			
	If yes, see 2.		If no, not a political subdivision.
2. Does the entity serve a governmental purpose? See 2A through 2C 2A. Does the organization carry out the public purposes that are set forth in the organization's enabling legislation?			
	If yes, see 2B.		If no, apply general facts and circumstances test for other relevant factors
2B. Does the entity operate in a manner that provides a significant public benefit with no more than incidental private benefit?			
	If yes, see 2C.		If no, apply general facts and circumstances test for other relevant factors
2C. Does the organization meet the "among other things" standard for establishing that it serves a governmental purpose?			
	If yes, see 3.		If no, apply general facts and circumstances test for other relevant factors.
3. Does a governmental unit have an ongoing right or power to direct significant actions of the entity. For these purposes, see the list of powers that "may establish control" and those that are deemed insufficient in the Proposed Regulations.			
	If yes, see 4.		If no, not a political subdivision
4. Is control vested in a state or local government? See 4A and 4B.			

[3] U.S. Census Bureau, 2012 Census of Governments, *Individual State Descriptions: 2012*, U.S. Government Printing Office, Washington, DC, 2013.

4A. Does the state or local government possess a substantial amount of each of the 3 sovereign powers?			
	If yes, see 4B.		If no, see 5.
4B. Is the state or local government acting through its governing body or through its duly authorized elected or appointed officials in their official capacities?			
	If yes, political subdivision		If no, see 5.
5. Is the electorate established under applicable State or local law of general application?			
	If yes, see 6.		If no, not a political subdivision.
6. Is the electorate a private faction? See 6A through 6C. 6A. Is the exercise of control determined solely by the votes of an "unreasonably small number of private persons"? For these purposes, take into account, among other possible factors, the organization's governmental purpose, the number of members of the electorate, the relationships of the members of the electorate and the extent to which the members of electorate adequately represent the interests of persons reasonably affected by the organization's actions.			
	If yes, not a political subdivision		If no, see 6B.
6B. Does the organization meet the safe harbor?			
	If yes, political subdivision.		If no, see 6C.
6C. Do 3 persons or less, in the aggregate, possess a majority of the votes necessary to determine the outcome of the relevant exercise of control?			
	If yes, not a political subdivision.		If no, apply facts and circumstances test.

Depending on the type of governmental organization at issue, the Proposed Regulations would change a single test into a series of facts and circumstances tests, many of which are both new and have very little in the way of helpful guidance. Whether an organization is authorized to issue tax-exempt bonds under federal tax law is too fundamental of an issue, and the ramifications are too great, to have the analysis be based on a multi-tiered set of new facts and circumstances tests. Contrary to the notion of providing certainty, interpretation of these tests will vary greatly under such amorphous standards.

In many respects, the Proposed Regulations resemble proposed Regulations issued in February of 1976, that would have defined the term "constituted authority" in section 1.103-1(b) of the Regulations (the "Proposed Constituted Authority Regulations").[4] Like the Proposed Regulations, the Proposed Constituted Authority Regulations contained a public purpose requirement and a control requirement. Under the Proposed Constituted Authority Regulations, in order to qualify as a constituted authority, the governmental organization's authorizing legislation would be required to specify the organization's public purpose, net earnings of the organization could not inure to any person other than the unit of government on whose behalf the organization was created, and "[t]he authority must [have been] created and operated solely to accomplish one or more of the public purposes of the unit specified in" its authorizing legislation. In addition, the governmental unit on whose behalf the organization was created would have been required to have either "organizational control" or "supervisory control" over the organization. Following the consideration of comments

[4] 41 Fed. Reg. 4829 (1976).

and a public hearing, the Proposed Constituted Authority Regulations were withdrawn in 1984.[5] Thus, Treasury and the IRS considered a similar approach in a related area of the law and concluded that approach should not be pursued. Nevertheless, whether an entity is a constituted authority involves a determination of whether the entity is controlled by a State or political subdivision. As noted below under "Unintended Consequences," the concept of control in the Proposed Regulations may be imported into other areas, including into the determination of what is a constituted authority even though that approach was rejected.

We also note that the Proposed Regulations do not contemplate situations in which more than one state or local government establishes or benefits from a governmental organization. Not only do the Proposed Regulations fail to account for these fact patterns, the standards set forth in the Proposed Regulations would be difficult to satisfy if applied to more than one governmental unit. For example, application of the incidental private benefit test to more than one governmental unit may lead to a conclusion that there is excess private benefit for one or some of the governmental units, but not the other(s). This would call into question whether those units could be controlling entities for the multijurisdictional entity. In addition, it is unclear how a governmental organization established by multiple governmental units could satisfy the control standards described in the Proposed Regulations if control is dispersed among the governmental units and, for instance, no governmental unit has the ability to appoint or remove a majority of the governing body.

Governmental Purpose – Federal Tax Governmental Purpose

Under the Proposed Regulations, in order to qualify as a political subdivision, an entity must serve a governmental purpose. The determination of whether an entity serves a governmental purpose is based, among other things, on whether the entity (1) carries out the public purposes that are set forth in the entity's enabling legislation, and (2) operates in a manner that provides significant public benefit with no more than incidental private benefit. The second specified factor would substitute Treasury and IRS discretion in place of that of state legislatures regarding what constitutes a public purpose. We believe that this is overreaching, will result in great confusion and will have a chilling effect on the investment in public infrastructure in many states.

As a threshold matter, we note that the governmental purpose standard described above is unclear. A standard that is "based on" two specified, and potentially on a number of unspecified, factors provides little in the way of useful guidance for governmental organizations seeking to qualify, or remain qualified, as political subdivisions.

State and local governments conduct an incredibly broad range of activities. The 2012 U.S. Census determined that, in addition to the 50 states, there are in excess of 90,000 local governmental units in the United States.[6] Attempts to enumerate or summarize the range of activities conducted by these entities would be futile. Even if it were possible to prepare such a list, once prepared it would almost certainly be immediately out of date in light of the constantly changing nature of the types of activities and services that citizens expect from state and local governments.

[5] 48 Fed. Reg. 55878 (1984).

[6] U.S. Census Bureau, 2012 Census of Governments, *Individual State Descriptions: 2012*, U.S. Government Printing Office, Washington, DC, 2013.

The preamble to the Proposed Regulations states that the governmental purpose element of the Proposed Regulations is derived from rulings under section 115 of the Code. Income is excluded from taxation under section 115 if it is derived from the exercise of any essential governmental function and accrues to a state or political subdivision. Numerous rulings have indicated that section 115 does not apply to governmental entities, but rather only to private entities engaging in governmental activities. As stated in a Field Service Advice dated April 29, 1996, if an entity is determined to be a political subdivision, "that finding has generally concluded any further inquiry as the Service historically has held that the income of such an enterprise is not subject to federal income tax." Further, in Revenue Ruling 77-261, 1977-2 C.B. 45, the IRS stated the following with respect to section 115:

> [S]ection 115(1) of the Code was intended to refer, not to the income of a State or municipality resulting from its own direct participation in industry, but rather to that part of the income of a corporation engaged in the operation of a public utility or the performance of some governmental function that accrued to a State or municipality. It . . . may be assumed that Congress did not desire in any way to restrict a State's participation in enterprises that might be useful in carrying out those projects desirable from the standpoint of the State government which, on a broad consideration of the question, may be the function of the sovereign to conduct.

Thus, section 115 was not intended to restrict "nongovernmental" activities of state and local governments, but rather was focused entirely on activities of private entities. Accordingly, it is inappropriate to incorporate the "governmental purpose" element found in section 115 rulings into the standard for determining political subdivision status.

Governmental Purpose - Significant Public Benefit and Incidental Private Benefit.

Section 1.103-1(c)(3) of the Proposed Regulations provides that, in assessing the governmental purpose requirement, "the determination of whether an entity serves a governmental purpose is based on, among other things, . . . whether the entity operates in a manner that provides a significant public benefit with no more than incidental private benefit" (the "Private Benefit Prohibition"). The Private Benefit Prohibition standard is not only inconsistent with current, well-established law, but also too vague to be applied by practitioners and administered consistently by regulators. Moreover, even if Treasury and the IRS were determined to add such a rule to the Regulations, the Regulations defining a political subdivision are an inappropriate place for such a rule. It is not feasible to have one of the most fundamental issues associated with tax-exempt bonds subject to such a nebulous facts and circumstances based test.

Where deemed appropriate, Congress and Treasury have limited the benefit of tax-exempt bonds accruing to a private entity through the private business use rules. There are numerous examples in current law of political subdivisions having the ability to issue bonds that provide more than an incidental private benefit, including through the issuance of qualified private activity bonds and the allowance for private business use (which, if the private security or payment tests are not satisfied, may in some instances represent 100% of the use of a bond-financed project).

The Private Benefit Prohibition is in many ways reminiscent of the private use rules set forth in the 1994 Proposed Regulations regarding the definition of private activity bonds (the "1994 Proposed Regulations").[7] The 1994 Proposed Regulations defined private use broadly – as potentially arising any time a bond financing transferred an economic benefit to a nongovernmental person, and as arising whenever bond proceeds are used to provide property that discharges a primary and unconditional legal obligation of a nongovernmental person.[8] When the final private activity bond regulations were promulgated in 1997, this broad definition of private use was rejected as was explicitly stated in Treasury Decision 8712.[9] The principles incorporated in the 1994 Proposed Regulations that were commented upon and deliberately excluded from the final private activity bond regulations should not be revived via amendment of section 1.103-1 of the Regulations.

A prohibition on nonincidental private benefit is also found under sections 115 and 501(c)(3) of the Code. Sections 115 and 501(c)(3) are aimed at entities that, by definition, are not political subdivisions. We believe it is improper, in the absence of any statutory language in section 103 that points toward applying a private benefit test, to apply such a standard in the context of entities that would otherwise qualify as a political subdivision.

Because the determination of whether an entity is a political subdivision is arguably the most fundamental determination that must be made before an issuer may issue tax-exempt bonds, clear and administrable standards are necessary for making this determination. The prohibition on nonincidental private benefit is anything but clear and administrable. As the IRS stated in the 2001 Exempt Organizations Continuing Professional Education Text:

> In reality it is difficult to apply the private benefit analysis. The Tax Court in *Church by Mail* may have said it best when it quoted its opinion in *Pulpit Resource v. Commissioner*, 70 T.C. 612 (1978), and stated that "decided cases provide only broad bench-marks, with the result that the 'relevant facts in each individual case must be strained through

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[7] See FI-72-88 (December 30, 1994).

[8] The following example of a discharge of a primary and unconditional legal obligation was set forth in section 1.141-3(b)(8)(ii) of the 1994 Proposed Regulations: "As a condition to obtaining a permit to construct an industrial development, Developer N unconditionally agrees that it will construct governmentally owned streets and sidewalks in the development. N and several other developers undertake to create District, a political subdivision. District issues its tax assessment bonds, the proceeds of which are used, in part, to construct the street and sidewalk improvements that N is obligated to construct. N's obligation to construct the improvements is unconditional and, therefore, the discharge of that obligation results in private business use of the proceeds used to construct those improvements."

[9] T.D. 8712 (January 10, 1997) states:

Economic benefit as private business use.

Under the proposed regulations, economic benefit to a nongovernmental person may be treated as private business use, even if the nongovernmental person has no special legal rights to use the financed property.

Commentators suggested that the private business use test should not be met unless special legal rights are provided to a nongovernmental person pursuant to an arrangement, and that mere economic benefit is insufficient to give rise to private business use.

The final regulations largely adopt these suggestions. The final regulations provide, however, that, if the financed property is not available for use by the general public, a nongovernmental person may be treated as a private business user of the property based on all of the facts and circumstances, even if that nongovernmental person has no special legal entitlements to use of the property.

> those [established] principles to arrive at a decision on the particular case.'" Ultimately, we must take the "facts and circumstances" of each individual case and apply the law discussed above to determine the presence of private benefit. For example, benefits that are nonincidental in one factual situation may be incidental in another given the totality of the circumstances.

Thus, the IRS itself has acknowledged that the private benefit analysis is difficult to apply. Furthermore, the IRS goes on to acknowledge that what constitutes a nonincidental benefit will vary depending on the facts. As a result, two entities performing the same function could arrive at different conclusions for purposes of determining whether they may issue tax-exempt bonds. As to where the line between incidental and nonincidental is, the IRS itself doesn't know, as there is no clear authority.

Governmental Control

The portion of the Proposed Regulations that amends and revises section 1.103-1 to add a new "governmental control" requirement (the "Control Provision") is inconsistent with the legislative intent of section 103 of the Code, is inconsistent with the manner in which many states have decided to form political subdivisions, could result in unreasonable and arbitrary consequences, and is impractical in application because of the nature of the "facts and circumstances" test.

We also believe that the Control Provision could lead to disparate results for entities performing similar functions, as units of state and local government that provide similar services are treated differently merely based upon size or the manner of appointment and removal of the members of its governing body. It does not seem appropriate to treat a small city differently from a larger municipality serving a similar function, or single-jurisdiction entities differently from multi-jurisdictional entities. Merely providing a facts and circumstances test to ascertain political subdivision status is not sufficient for a unit of government needing to obtain an unqualified opinion regarding its ability to be an issuer of tax-exempt obligations. We note that small and multi-jurisdictional units of government exist in many states, including such entities serving as cities, towns and service districts, providing crucial services to rural areas, as well as airport authorities and transportation authorities that provide public infrastructure financing and operation on a regional basis.

Both the Control Provision and the Private Benefit Prohibition appear aimed at limiting the use of tax-exempt bonds and bond-financed property by private persons. Congress and Treasury have already provided third-party use limitations in section 141 of the Code. We note that the Proposed Regulations are inconsistent with the "temporary use by developers" exception in section 1.141-3(d)(4) of the Regulations, which provides for an exception to private business use for a temporary period for developers during an initial development period. It seems odd that an organization satisfying the private business use exception in section 1.141-3(d)(4) of the Regulations, and with a substantial amount of one of the three sovereign powers of government, would not be classified as a political subdivision under section 103 of the Code.

The Control Provision is overly broad. Dozens and perhaps hundreds of small-population governmental entities, such as towns, are likely to be impacted by the Control Provision. Finally, the Proposed Regulations state that, for purposes of determining the number of voters and voter control, related parties (as defined in section 1.150-1(b) of the Regulations) are treated as a single person. Governmental organizations would be required not only to have the requisite number of voters, but they would also be responsible for evaluating familial relationships.

Unintended Consequences

By creating this new framework for determining whether an entity constitutes a "political subdivision," the Proposed Regulations will result in a number of unintended consequences, within and outside of the rules applicable to tax-exempt bonds, and even outside federal income tax law.

Under the Proposed Regulations, should an entity fail the sovereign powers test, the governmental purpose test or the governmental control test, not only could it not issue tax-exempt bonds, but its use of bond-financed facilities would constitute private use and may, therefore, be shut out from governmental borrowing programs such as state clean water revolving loan programs. It would also potentially be liable for federal income tax on its taxable income. In this regard, section 115 of the Code, which provides an exclusion from federal gross income for entities that do not purport to be political subdivisions, would not apply to protect it.

Another potential unintended consequence pertains to the use of the word "control" in various contexts other than whether an entity constitutes a political subdivision. The question is whether the new definition of control in section 1.103-1(c)(4)(i) of the Proposed Regulations would inform the interpretation of control in other existing authorities. For example, in the context of section 103(c)(1) of the Code, Revenue Ruling 57-128, 1957-1 C.B. 311, sets out six criteria for evaluating whether an entity is an "instrumentality" of a state or local governmental unit. Instrumentalities are eligible issuers of tax-exempt bonds. Revenue Ruling 57-128 has as one of its criteria "whether control and supervision of the organization is vested in public authority or authorities." To the extent the Proposed Regulations' new definition of control may be thought to inform control in other contexts such as this, the IRS may have, through the Proposed Regulations, changed the law in ways it had not intended.

The term "political subdivision" appears in approximately 150 Code sections, including, in the context of tax-exempt and tax-advantaged bonds, sections 54, 54B, 54C, 115, 142, 143, 146, 147, 149, 150, 162, 171, 265, 501, 511, 512, 513, 1400L, 1400N and 7871. Although Treasury has publicly stated that the definition of political subdivision in the Proposed Regulations would apply only for purposes of section 103 of the Code, we are concerned that the many cross-references to the term throughout the Code would result in significant confusion.

Conclusion

For the reasons set forth above, NABL respectfully requests that the Proposed Regulations be withdrawn, and that the notice of withdrawal affirm the applicability of the Shamberg rule as the sole standard for evaluating a governmental entity's status as a political subdivision under section 103(c)(1) of the Code.